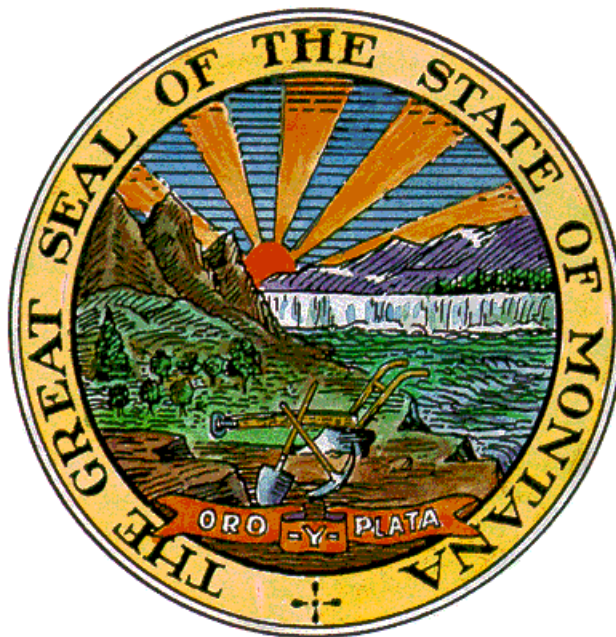


Montana

Comprehensive Annual Financial Report



June 30, 1997

MONTANA
COMPREHENSIVE ANNUAL
FINANCIAL REPORT
for the fiscal year ended June 30, 1997

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STATE OF MONTANA

SELECTED STATE OFFICIALS

EXECUTIVE

Marc Racicot

Governor

Judy Martz

Lieutenant Governor

JUDICIAL

J. A. Turnage

Chief Justice

LEGISLATIVE

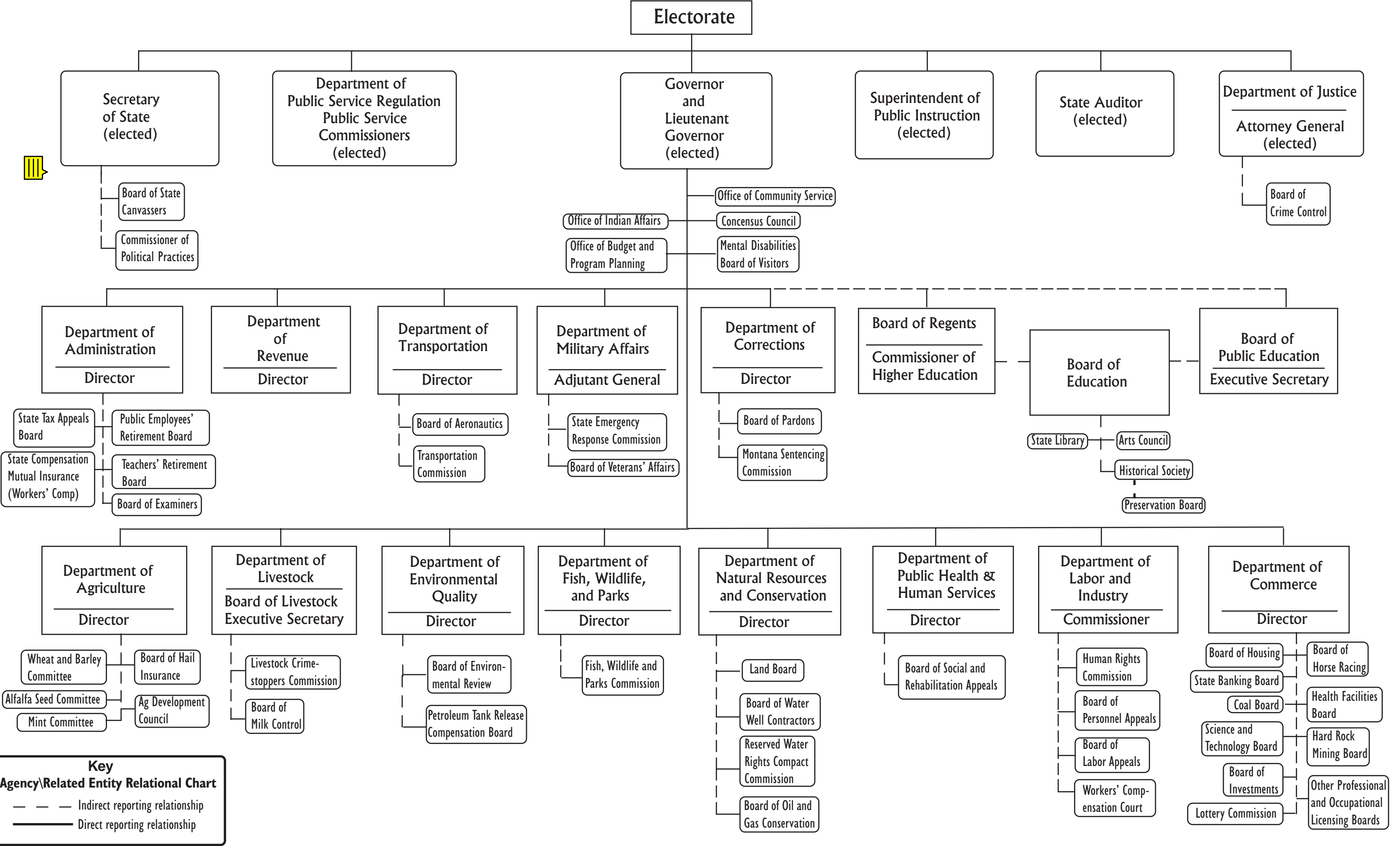
Gary Aklestad

President of the Senate

John Mercer

Speaker of the House

Montana Executive Branch



**STATE OF MONTANA
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FISCAL YEAR ENDED JUNE 30, 1997**



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**STATE OF MONTANA
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General Fixed Assets Account Group

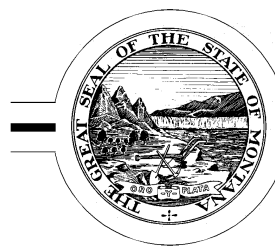
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DEPARTMENT OF ADMINISTRATION

DIRECTOR'S OFFICE



MARC RACICOT, GOVERNOR

MITCHELL BUILDING

STATE OF MONTANA

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October 30, 1997

To the Citizens, Governor and Members of the Legislature of the State of Montana:

In accordance with Section 17-2-110, Montana Code Annotated (MCA), I am pleased to submit the Comprehensive Annual Financial Report (CAFR) of the State of Montana for the fiscal year ended June 30, 1997. Responsibility for the accuracy of the data presented and the completeness and fairness of the presentation rests with the Department of Administration. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds and account groups of the State of Montana. All disclosures necessary to enable the reader to gain an understanding of the State's financial activities are included.

Description of the CAFR

This report and the accompanying financial statements and statistical tables were prepared in accordance with standards set forth by the Governmental Accounting Standards Board (GASB).

This CAFR is divided into three main sections: introductory, financial and statistical. The introductory section includes an organization chart for the State, a table of contents and this transmittal letter. The financial section contains the independent auditor's report, the general purpose financial statements, notes to the financial statements, combining statements by fund type, and other schedules. The statistical section includes financial, economic and demographic data.

This report includes all funds and account groups of those entities that comprise the State of Montana (the primary government) and its component units. The component units are entities that are legally separate from the State but for which the State is financially accountable, or whose relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the State is able to impose its will on that organization or (2) there is the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the State. The following component units are included in the State's financial reporting entity: Housing Authority, Health Facilities Authority, State Compensation Insurance Fund (Old and New), Teachers' Retirement System and the Colleges, Universities and Colleges of Technology. These component units are discretely presented in the State's financial statements.

Economic Condition and Outlook

Montana continued to experience an anticipated economic slowdown after undergoing a record economic expansion in the first four years of the 1990's. Montana's non-farm labor income average annual growth rate declined another 0.1 percent to 2.7 percent in 1996, down from 3.7 percent in 1994 and the 4.0 to 5.0 percent growth rates in the early 1990's. As Paul Polzin, director of the University of Montana Bureau of Business and Economic Research, indicated, the slowdown was expected. The rapid growth rate in the early 1990s was due to temporary factors such as a construction boom and would eventually end. Montana is now decelerating toward a sustainable growth rate of about 2 percent per year.

Personal income is projected to increase by 1.8 percent in 1996 with continued growth projected at about 2.2 percent per year from 1997 to 1999. Slower growth in transfer payments and dividends, interest, and rents, as well as the overall economic slowdown, has reduced personal income growth. Montana's non-farm wage and salary jobs increased by 8,300 in 1996. Construction activity was the key factor, differentiating fast and slow growing communities in Montana from 1990 to 1995. However, it is the service sector, primarily the health care industry and government, that provide the majority of non-agricultural jobs. Most new jobs have been and will be in business and personal services. The job market is expected to increase at a more moderate rate of 6,500 jobs per year in the next few years.

Although Montana's population continues to increase, the annual growth rate has begun a projected slow down. The 1996 population, estimated to be 879,000, reflects an increase of 80,000 or 10.01 percent since 1990. The 1.6 percent average annual increase in the 1990's compares to the meager 0.2 percent average annual population growth for the state in the 1980's. Montana's population is projected to exceed 1 million in 2010. The annual rate of growth is expected to average 1.1 percent through the latter years of the decade slowing down to a 1.0 percent annual growth rate in the first decade of the next century.

Agriculture continues to be Montana's largest basic industry. It accounts for over 30 percent of the state's employment, labor income and gross sales. Approximately 64 percent of the state's 93 million acres is used for farming and ranching. Montana agriculture generates about \$2 billion in cash receipts. Although the long-term prospects for agriculture appear strong, there is some significant risk. Livestock prices continued to decline in 1996 and it is expected to be one more year before cattle prices rebound significantly from these low prices. Wheat prices have been very good for the last few years due, in part, to relatively low yields in other parts of the U.S. and other wheat producing regions around the world. As these regions return to more normal production, wheat prices are expected to decline. In addition, the planting flexibility associated with FAIR Act may cause some shifting of production out of wheat to more highly valued crops which will have a modest impact on wheat prices. Government transfer payments will decline over the next six years forcing Montana producers to be more dependent on the market place. If farm profitability remains low, this sector may not reach the long-term statewide growth rate of 2.0 percent.

Most of Montana's traditional manufacturing industries had stable or increasing employment and payrolls during the early 1990's. Manufacturing employment has increased 15 percent in the last decade. The overall outlook for manufacturing is for modest growth. However, further reductions in timber availability could result in corresponding wood products industry decreases, which account for almost half of manufacturing employment and labor income. Market conditions for lumber and plywood in 1997 should be about on a par with 1996, with a slightly weaker U.S. housing industry but improved commercial construction activity and continued improvements in overseas markets. Paper markets should also be somewhat improved. Timber availability remains the major downside risk for the wood products industry. A sustained national forest timber program comparable to 1996 would indicate a stable industry; without timber from the national forests, Montana's wood products industry could decline by 20 to 30 percent.

Montana also has aging industrial plants that may find it increasingly difficult to comply with stringent environmental regulations as well as ruthless international cost competition. Montana's small manufacturers may also find it advantageous to transfer some production offshore, thereby reducing their employment in the state. On the positive side, some new facilities opened in 1996 and there are new plants under construction and under consideration. Manufacturing grew very rapidly in the last decade, in particular in high tech and electronics and sporting goods. Continued growth is expected but at a slower pace than in the last five years.

Major Initiatives

The focus of fiscal year 1997 and the 1997 legislative session was on increasing funding for education, controlling the ever growing prison population, property tax reform, welfare reform and information technology. Because of Montana's stable economy and population growth, the State continued to increase funding for education and public safety. The legislature and the Governor continued the implementation and expansion of the business personal property tax reduction, dramatically reduced the immediate impact of reappraisal of real property and reduced other taxes in an effort to improve Montana's economic competitiveness.

The legislature approved state school support increases of \$47.1 million in the general fund with funding for entitlement increases, expansion of school facility aid, initiation of a technology funding program and an appropriation for a one-time influx of new money to be used at each school's discretion for textbooks, technology, building maintenance, or library materials. In addition, the legislature approved funding for an effort to improve and measure the productivity and accountability of schools. Increases in district property tax obligations of over \$15 million for Guaranteed Tax Base (GTB) payments which would have resulted from cyclical reappraisal were shifted to the State.

The budget includes funding to reimburse schools and local governments for reducing the Montana business personal tax to its lowest level this century. Montana had the highest business taxes in the nation, and the continuation of this reduction allows the State to compete for new investments, jobs and economic opportunity. The reduction of this tax by one-third, as adopted by the 1995 Legislature, will cost an additional \$22 million in the 1999 biennium. In addition, the legislature chose to phase in the reappraisal of real property in classes 3,4, and 10. This phase-in allows property taxpayers to avoid an increase of nearly \$80 million in taxes during the 1999 biennium.

The legislature provided \$40 million in new general funds above the 1997 biennium funding levels to strengthen corrections programs at the state and local level. Construction of nearly \$31 million in new facilities was approved. The legislature continued to fund an expansion of the number of prison beds purchased privately from other states and authorized a request for proposal (RFP) to develop private prisons in Montana. Although this is a large investment, the projected increase in the number of offenders who are not eligible for placement in a non-prison setting requires the expansion of prison space in order to ensure the safety of law-abiding Montanans.

A number of executive initiatives which received the support of previous legislatures have contributed to the ability of the State to begin to control the rate of growth in major benefit programs such as Medicaid and welfare. The State implemented its Mental Health Managed Care initiative. The initiative will establish Medicaid eligibility for mental health benefits for families and persons with incomes at or below 200 percent of the federal poverty level; determine eligibility by income only (no resource limits will be imposed); charge families with higher incomes for services based on a sliding fee scale; and include services to adults and children. In addition, Montana expanded the physical health managed care program entering into a contract with an outside provider to administer HMO and the Passport managed care programs.

The 1997 legislature approved the use of bonding to fund information technology projects for the first time in the state's history. Authorization was granted to five executive branch agencies and the university system to move forward with major information technology initiatives that will cost nearly \$43.0 million, all of which are to be funded by the issuance of general obligation debt. Montana state government will use this funding to replace many of the state's primary legacy systems currently used to manage information regarding state personnel, accounting, budgeting, revenue collection and tax administration. In addition, projects funded will be used to address much of the state's "Year 2000" problem.

Financial Information

Montana's Statewide Budgeting and Accounting System (SBAS) is a centrally maintained, fully computerized, double-entry accounting system. SBAS records are computer-edited.

Management of the State is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the State are protected from loss or misuse and that adequate accounting data are compiled to allow for the preparation of financial statements in accordance with generally accepted accounting principles.

In developing and evaluating the State's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance that the above objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived, and that the evaluation of costs and benefits requires estimates and judgments by management.

Budgetary restrictions are imposed via appropriations approved by the legislature or established administratively as provided for by state law. Appropriations are required by state law for the General, Special Revenue, and Capital Projects Funds. The level of budgetary control is generally established by program and fund. SBAS is designed to provide budgetary control by preventing spending in excess of legislative and administrative authority and/or available cash. SBAS also provides for encumbrance accounting as a technique for accomplishing budgetary control.

General Governmental Functions

Revenue sources for general governmental functions, which include the General, Special Revenue, Debt Service, and Capital Projects Funds, increased 2.5 percent from fiscal year 1996 to fiscal year 1997. Revenues from various sources for fiscal year 1997, and the amount and percentage of increases and decreases in relation to prior year revenues, are shown in the following table:

<u>Revenue Source</u>	<u>Amount (in thousands)</u>	<u>1997 Percent of Total</u>	<u>Increase (Decrease) from 1996</u>	<u>Percent Increase (Decrease)</u>
Licenses/Permits	\$ 112,761	5.2%	\$ 2,718	2.5%
Taxes	1,041,840	48.2	43,966	4.4
Charges for Services/Fines/Forfeits	93,629	4.3	27,262	41.1
Investment Earnings	28,741	1.4	147	0.5
Securities Lending Income	8,346	0.4	8,346	100.0
Sale of Documents/Etc.	5,828	0.2	(948)	(14.0)
Rentals/Leases/Royalties	212	-	(8)	(3.6)
Contributions/Premiums	4,211	0.2	46	1.1
Grants/Contracts/Donations	7,759	0.4	(1,473)	(16.0)
Federal	853,051	39.5	(27,249)	(3.1)
Federal Indirect Cost Recoveries	1,937	0.1	252	15.0
Other Revenues	<u>972</u>	<u>0.1</u>	<u>(580)</u>	<u>(37.4)</u>
Total Revenues	<u>\$2,159,287</u>	<u>100.0</u>	<u>\$ 52,479</u>	

An explanation of significant changes by revenue source follows:

Licenses/Permits - The increase in revenue was primarily due to 1) a \$2.3 million increase in vehicle licenses and permits; 2) a \$0.8 million increase in investment licenses and permits; and 3) a \$0.5 million increase in drivers' licenses offset by 4) a \$1.3 million decrease in nonresident wildlife hunting licenses and permits.

Taxes - The increase in revenues was primarily due to 1) a \$24.1 million increase in individual income tax receipts; 2) a \$5.6 million increase in property tax collections due to reassessment; 3) a \$5.2 million increase in corporate income tax collections; 4) a \$4.6 million increase in oil production tax collections offset by a \$1.1 million decrease in resource indemnity trust tax collections; 5) a \$2.7 million increase in gasoline license tax collections; 6) a \$0.9 million increase in the accommodations tax; and 7) smaller increases in the insurance premium tax, cigarette/tobacco taxes, public contractors' tax and electrical energy tax amounting to a total of \$1.7 million.

Charges for Services/Fines/Forfeits - The increase in revenues was primarily due to 1) a \$19.1 million increase costs recovered from the Montana Pole EPA clean-up in Butte, Montana; 2) a \$4.2 million increase in county billing reimbursements; 3) a \$3.6 million increase in institutional care cost recoveries; 4) a \$2.0 million in foster care cost recovery payments from the counties; and 5) a \$1.5 million increase in repayments of funds loaned to local governments by the Montana Department of Transportation for road repair and maintenance offset by 6) a \$1.6 million decrease in district court fees.

Securities Lending Income - The reporting of securities lending income separate from other investment earnings is a result of implementation of GASB Statement No. 28.

Sale of Documents/Mdse./Property - The decrease in revenue was primarily due to a decrease in sales of the Montana Code Annotated (MCA); sales of the MCA occur biennially in even years following legislative sessions which occur in odd-numbered years.

Grants/Contracts/Donations - The decrease in revenue was primarily due to a \$1.1 million decrease in environmental impact study contract work done by the Department of Environmental Quality related to the decrease in federal money received by the State for abandoned mine reclamation work along with a \$0.4 million decrease in job training contract work.

Federal - The decrease in revenue was primarily due to 1) a \$10.1 million decrease in highway trust fund money distributed to the State; 2) a \$5.8 million decrease in U. S. mineral leasing royalties received by the State; 3) a \$4.3 million decrease in abandoned mine reclamation monies; 4) a \$2.9 million decrease in AFDC/TANF money received by the State; 5) a \$1.7 million decrease in benefits paid through the weatherization program; 6) a \$1.0 million decrease in federal funding received for the Montana Pole Superfund Project; and 7) smaller decreases amounting to a total of \$1.9 million in JTPA funding, HUD-Low Income Housing money and funding for the Juvenile Justice Council.

Total expenditures for all general governmental functions increased 3.1 percent from fiscal year 1996 to fiscal year 1997. Expenditures by function for fiscal year 1997, and the amount and percentage of increases or decreases in relation to the prior year amounts, are shown in the following table:

Expenditure Function	Amount (in thousands)	1997 Percent of Total	Increase (Decrease) from 1996	Percent Increase (Decrease)
General Government	\$ 81,646	3.7%	\$ 9,947	13.9 %
Public Safety/Corrections	128,247	5.8	9,026	7.6
Transportation	325,182	14.8	3,040	0.9
Health/Social Services	788,429	35.9	17,923	2.3
Education/Cultural	555,610	25.3	4,006	0.7
Resource Development/Recreation	92,972	4.3	23,708	34.2
Economic Development/Assistance	105,752	4.8	(1,040)	(1.0)
Securities Lending	7,887	.4	7,887	100.0
Debt Service	39,037	1.8	(21,923)	(36.0)
Capital Outlay	70,182	3.2	13,162	23.1
Total Expenditures	<u>\$2,194,944</u>	<u>100.0</u>	<u>\$ 65,736</u>	

An explanation of significant changes by expenditure function follows:

General Government - The expenditure increase was primarily due to increases in operating costs for the legislative branch and the Office of Budget and Program Planning as well as the Governor's Office as a result of the legislature being in session in the first four months of calendar year 1997. In addition there were increases in the general operation of the Judiciary Branch, the 9-1-1 Program and the Accounting and Management Support Division of the Department of Administration and the director's office in the Department of Revenue.

Public Safety/Corrections - The expenditure increase was primarily due to 1) a \$6.6 million increase in secure facilities costs incurred by the Department of Corrections in order to pay for incarcerating the excess prison population in a private prison in Texas; 2) a \$1.0 million increase in grants to local governments for disaster recovery work as a result of flooding, train derailments and other disasters; and 3) increases in crime control program costs and highway patrol operating costs for a total of \$1.6 million.

Transportation - Expenditure increases were primarily due to an increase in transportation planning costs, maintenance program costs (state funds) and general operating costs of the Montana Department of Transportation offset by a decrease in highway construction costs as a result of the receipt of fewer federal highway construction funds.

Health/Social Services - The expenditure increase was primarily due to 1) an \$18.2 million increase in the Addictive and Mental Health Services as a result of implementing the mental health managed care initiative; 2) a \$7.2 million increase in remediation costs incurred by the Department of Environmental Quality; 3) a \$5.0 million increase in benefits and claims paid by the Child Support Enforcement program; 4) a \$2.9 million increase in the benefits and claims costs paid by the Petroleum Tank Release program; and 5) a \$2.0 million increase in program costs for the Disability Services Division programs offset by 6) a \$13.4 million decrease in Medicaid benefit payments paid to

general welfare recipients and 8) a \$4.1 million decrease in AFDC and foster care benefit and grant payments made by Child and Family Services.

Education - The expenditure increase was primarily due to increases in distributions to public schools as a result of increased enrollment offset by slight decreases created by the elimination of the vocational education council operations and reductions in student assistance payments and Carl Perkins program costs.

Resource Development/Recreation - The expenditure increase was primarily due to 1) a \$13.8 million increase in water resources program costs; 2) a \$4.9 million increase in forestry program costs; and 3) a \$3.7 million increase in the conservation/resource development program costs; all three programs are operated by the Department of Natural Resources and Conservation. In addition, the general program costs of the Department of Fish, Wildlife and Parks increased \$2.2 million.

Economic Development/Assistance - The expenditure decrease was primarily due to a reorganization and streamlining of job service division operations in the Department of Labor and Industry.

Debt Service - The expenditure decrease was primarily due to 1) the refunding of three Coal Severance Tax Renewable Resource Program bonds in fiscal year 1996 resulting in \$14.2 million in additional debt service cost in fiscal year 1996 compared to fiscal year 1997, and 2) the structuring of debt payments for both the long-range building program and special revenue bonds backed by the coal severance trust fund that provides for higher initial principal payments the first few years of the bonds and significantly reduced principal payments the remaining years beginning in fiscal year 1997.

Capital Outlay - The expenditure increase was primarily due to 1) a \$6.5 million increase in the Historical Society for the purchase of historic Virginia City/Nevada City and associated artifacts; 2) a \$4.9 million increase in construction projects related to fish hatchery and state park/fishing access sites; and 3) a \$2.2 million increase in highway construction projects by the Montana Department of Transportation.

General Fund Balance

The unreserved fund balance of the General Fund remained relatively unchanged increasing from \$30.145 million at June 30, 1996, to \$30.315 million at June 30, 1997. This represents an increase of \$0.170 million, or 0.056 percent.

Enterprise Operations

The State of Montana provides numerous goods and services to the public on a user charge basis, similar to a private business. Profits from two of these operations, the State Liquor Stores and the State Lottery, are used to fund other services provided by the State. Following is a summary of the operating results of these two entities in fiscal year 1997:

State Liquor Stores - The State regulates the sale, importation, distribution and manufacturing of alcoholic beverages in Montana. A portion of the liquor sales and excise and license taxes collected through this function along with any profits generated through the administration of this regulatory function, including those from the operation of the liquor stores, are transferred to the General Fund. In fiscal year 1997, \$13.493 million was transferred to the General Fund, compared to \$15.073 million in fiscal year 1996.

State Lottery - The Montana State Lottery was created by the electorate through the passage of Referendum 100 during the 1986 general election. Profits generated by this operation are transferred to the General Fund and appropriated to the Office of Public Instruction (OPI) for distribution to local school districts and the Board of Crime Control (BCC) for grants to counties for youth detention services. Profits for fiscal year 1997 were \$6.6 million with OPI receiving 90.9 percent and BCC 9.1 percent of the net revenue.

Pension Trust Fund Operations

The State contributes to eight retirement systems and is the administrator of one additional system. The two largest systems in terms of dollars contributed and employees covered are the Public Employees' Retirement System and the Teachers' Retirement System. Montana implemented GASB Statement 25 - Financial Reporting for Defined Benefit Pension Plans and note Disclosures for Defined contribution Plans and GASB Statement 27 - Accounting for Pensions by State and Local Governmental Employers in fiscal year 1996. The funded actuarial accrued liability ratio for all systems continued to improve with the exception of the Judges' Retirement System.

The 1997 legislature enacted legislation that establishes a guaranteed annual benefit adjustment (GABA) for enrolled members or surviving beneficiaries under each of the statewide public employee retirement systems. The annual minimum adjustment of 1.5 percent will begin 36 months after a beneficiary's initiation date. The benefit adjustment, when combined with other benefit adjustments already in law, must equal at least 1.5 percent per year. Beneficiaries in the retirement systems for public employees, sheriffs and game wardens are automatically covered by the GABA. Beneficiaries in the retirement systems for highway patrol officers municipal police officers, firefighters unified and judges may choose to be covered by GABA or by benefits adjustment mechanisms already in place. The legislation establishing the GABA also provides a mechanism to actuarially fund the Judges' Retirement System.

Debt Administration

Montana receives excellent bond ratings from both Moody's Investors Service (Aa) and Standard & Poor's Corporation (AA-). State debt may be authorized either by a two-thirds vote of the members of each house of the legislature or by a favorable vote of a majority of the State's electors voting thereon. There is no constitutional limit on the amount of debt that may be incurred by the State. The Montana Constitution does, however, prohibit the incurring of debt to cover deficits caused by appropriations exceeding anticipated revenue. General obligation debt increased from \$69.62 million at June 30, 1996, to \$96.62 million at June 30, 1997.

The ratio of general obligation debt to assessed valuation and the amount of general obligation debt per capita are:

	<u>Amount (in thousands)</u>	<u>Ratio of Debt to 1996 Assessed Value</u>	<u>State Debt Per Capita*</u>
General Obligation Debt	\$96,620	0.26%	\$109.92

* Based on 1996 estimated Montana population.

Cash Management

The uniform investment program established by the 1972 Montana Constitution directs that the Board of Investments has sole authority to invest State funds. The Board operates under the "prudent person principle" which requires the Board to 1) discharge its duties in the same manner as that of a prudent person acting in a like capacity with the same resources and aims; 2) diversify the holdings of each fund to minimize the risk of loss and maximize the rate of return; and 3) discharge duties solely in the interest of and for the benefit of the funds managed. Permissible investments include bonds, notes, debentures, equipment obligations, common stock (pension trust and higher education funds only), commercial paper, bankers' acceptances, interest bearing deposits in Montana financial institutions, real estate and any other investment in a Montana business that continues existing jobs or creates new jobs. These investments are subject to statutory restrictions for quality and size of holdings.

Unless otherwise provided by law, treasury cash is pooled for investment regardless of the fund from which it is deposited and the pool's investment earnings are credited to the General Fund. The Board reported total investment income from investments under its management of \$368.6 million, an increase of 3.6 percent from the \$355.7 million earned last year. The book value of Board-managed investments increased by \$0.16 million or less than 1.0 percent to \$4.91 billion at fiscal year-end 1997. The Board publishes an annual audited report of all its investment activity. That report may be referenced for more in-depth investment information.

In order to provide cash to support expenditures from the General Fund, pending the receipt of taxes and revenues, the Board of Examiners, upon the recommendation of the Department of Administration, issued \$110.7 million in Tax and Revenue Anticipation Notes in September 1997. These notes will be redeemed by the State in June 1998.

Risk Management

The State of Montana provides benefit coverage for injured state employees through participation in the State Compensation Insurance Fund (State Fund). The State Fund is a nonprofit, independent public corporation which is managed and controlled by a five-member board of directors. The board members are appointed by the Governor for four-year terms. Funding is primarily derived from the premiums paid by policyholders.

The 1991 Legislature passed legislation authorizing the Board of Investments to issue up to \$220 million in bonds to provide further funding for the State Fund - Old and to utilize the employer payroll tax to redeem the bonds issued. The employer payroll tax, which provides funding for bond payments, has been increased and extended to employees and the self-employed. On July 15, 1991, \$142.095 million in bonds were issued payable from and secured by the employer payroll tax revenues. On October 27, 1993, the Board issued its second series of payroll tax bonds in the principal amount of \$32.5 million.

On July 24, 1995, and March 26, 1996, the State Fund applied \$21,495,949 and \$13,211,766, respectively, of Old Fund Liability Tax (OFLT) collections to defease \$33,955,000 of the Series 1991 Payroll Tax Bonds. On September 24, 1996, the Board of Directors of the State fund declared a dividend payable to the Old fund not to exceed \$109 million from excess surplus funds. On October 3, 1996, the State fund applied \$80,061,243 of the \$109 million dividend plus \$11,322,812 of Debt Service Reserve funds and \$8,000,000 of excess OFLT collections not required to pay claims to defease the remaining portion of the Series 1991 Payroll Tax Bonds. The State Fund - Old recognized an extraordinary loss on extinguishment of debt of \$3,208,210. On January 2, 1997, the State Fund - Old paid the final principal and interest payments from cash available from a cash dividend, the bond reserve fund and funds in excess of the amount needed to pay Old Fund claims and the balance of Variable-Rate Payroll Tax Bonds was removed from the Old Fund's financial statements. The early payment of this debt resulted in an extraordinary loss on extinguishment of debt of \$326,990.

At June 30, 1997, liabilities for the State Fund - Old exceeded assets by \$183.2 million. The actuarially determined liability for unpaid claims, including those which were incurred but not reported, decreased to \$205.7 million

undiscounted. This represents a decrease of \$43.1 million in estimated claims liability from fiscal year 1996. The percentage of this liability belonging to the state as a participant is unknown. For the State Fund - New, assets exceeded liabilities by \$159.5 million at June 30, 1997. The actuarially determined liability for unpaid claims, including those which were incurred but not reported, was \$344,632,133 presented at their net present value of \$315,107,230. These claims are discounted at an annual rate of 4.0 percent.

The State maintains self-insurance plans for employee comprehensive medical and dental coverage and state property. Under the State Employee Group Benefits Plan the State assumes all the risk for claims incurred by plan members including State employees, elected officials, retirees and their dependents. Premiums are collected through payroll deductions, deductions through the Public Employees' Retirement System and self-payment. For the period ending June 30, 1997, the plan reported retained earnings of \$25.45 million, an increase of \$0.73 million over June 30, 1996.

The Montana University System Group Benefits Plan offers medical, dental, and vision insurance coverage to employees of the Montana University System, the Montana Higher Education Student Assistance Corporation (MHESAC), and the State Bar of Montana, as well as their dependents, retirees, and COBRA members. The MUS Group Benefits Plan is fully self-insured. Blue Cross/Blue Shield is the claims administrator for the plan. Managed Care Montana (Blue Cross/Blue Shield of Montana) has a contract for utilization management. The utilization management program consists of hospital pre-authorization, case management and medical necessity review. For the period ending June 30, 1997, the plan reported retained earnings of \$0.50 million, a decrease of \$3.72 million over June 30, 1996.

The State's property insurance plan provides coverage for general liability, automobile liability, automobile physical damage, and state-administered foreclosure housing units. The State self-insures the \$150,000 deductible per occurrence for most property insurance as well as various deductible amounts for other state property. The state also self-insures against losses of equipment below \$150,000 of value, with state agencies paying the first \$1,000. Commercial property insurance protects over \$1.8 billion of state-owned buildings and contents. The flood and earthquake liability limit is \$100 million per occurrence with a \$1.0 million deductible for earthquakes and a \$0.5 million deductible for floods. Premiums for the plan are collected from all State agencies, including component units. Based on the most recent actuarial report prepared by Tillinghast and issued for the period July 1, 1988 through June 30, 1997, a liability of \$12.8 million, discounted at 11.1 percent, is recorded in the accompanying financial statements for estimated claims including those incurred but not reported. This represents a decrease of \$2.2 million in estimated claims liability from fiscal year 1997.

Independent Audit

The financial statements contained in Montana's Comprehensive Annual Financial Report were audited in accordance with generally accepted auditing standards by the Legislative Audit Division. The Legislative Auditor is appointed by and reports to the Legislative Audit Committee. The Deputy Legislative Auditor issued an unqualified opinion on the State's financial statements for fiscal year 1997.

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Montana for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 1996. This was the tenth consecutive year that the State received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR, whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current CAFR continues to conform to the Certificate of Achievement Program requirements; we are submitting it to GFOA to determine its eligibility for another Certificate.

Acknowledgments

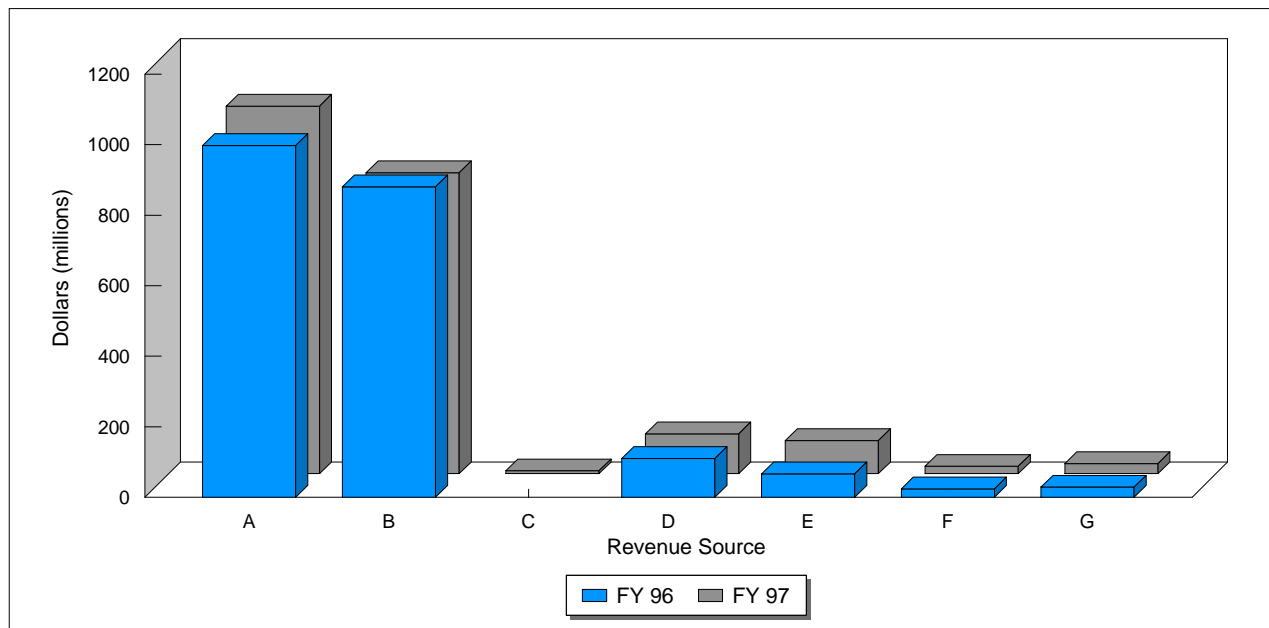
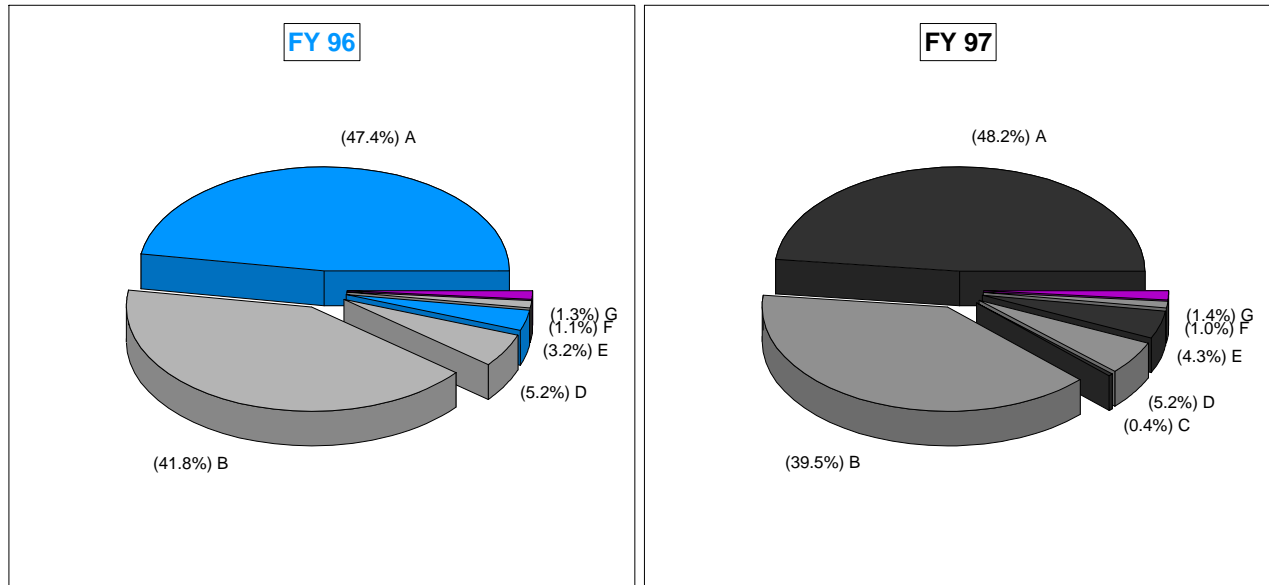
The preparation of this report on a timely basis could not be accomplished without the efficient and dedicated service of the entire staff of the Accounting Bureau and the cooperation of accounting personnel at the individual State agencies. I would like to express my appreciation to Accounting Bureau and other agency personnel who participated in the preparation of this document. I would also like to thank the legislature and all State agencies for their interest and support in planning and conducting the financial operations of Montana in a professionally responsible and progressive manner.

Respectfully submitted,

(Signature on File)

Lois Menzies, Director
Department of Administration

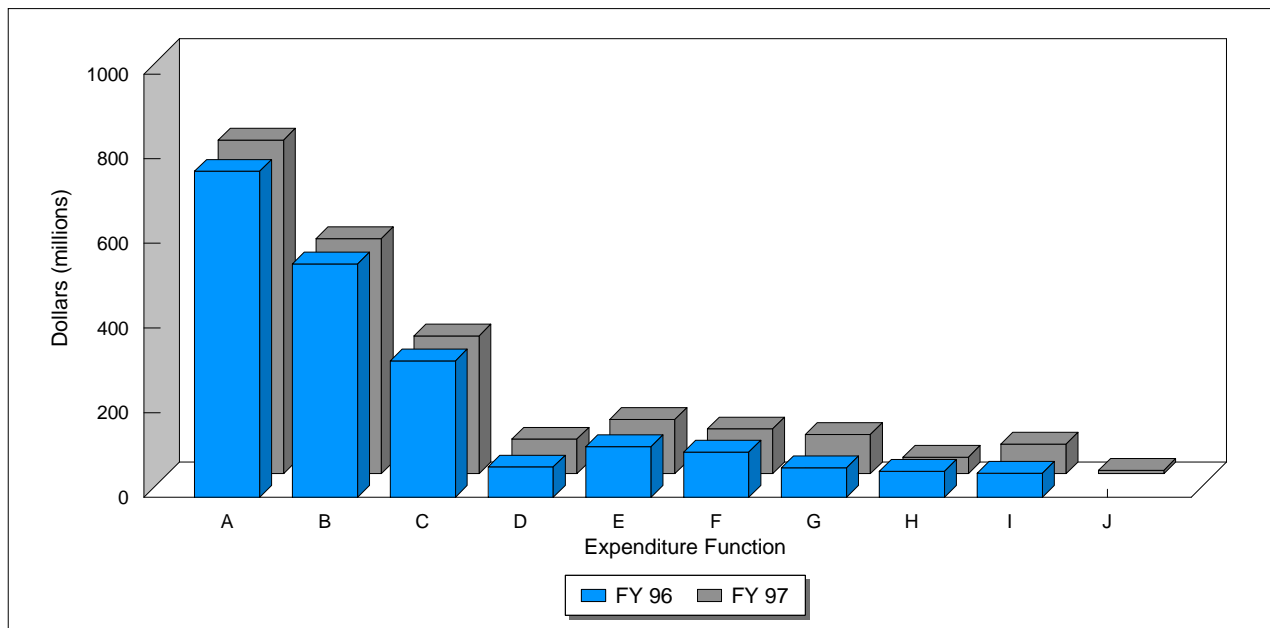
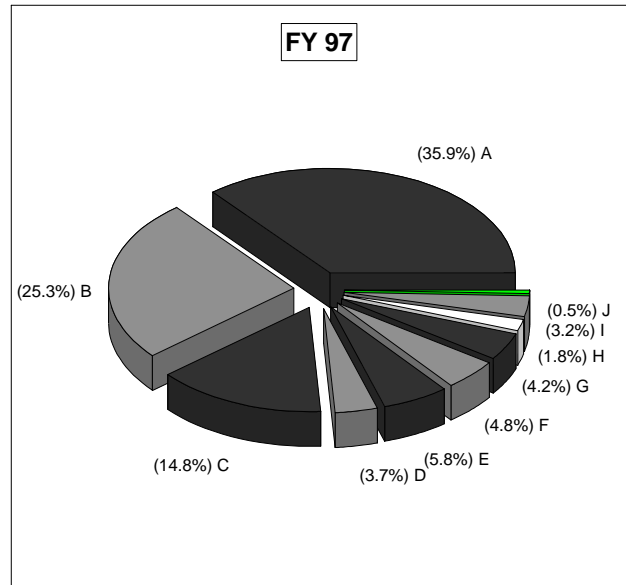
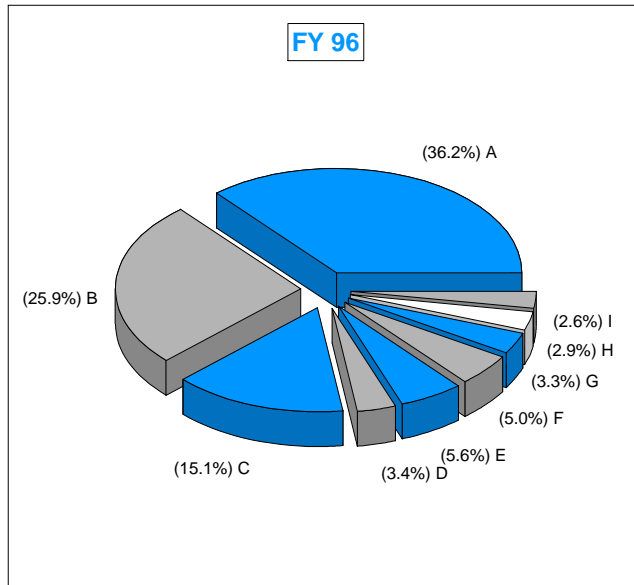
State of Montana Revenues by Source All Governmental Fund Types



Legend:

- | | |
|---|---|
| (A) Taxes | (F) Other Revenues (includes contributions, premiums, rentals, leases, royalties, grants, contracts, donations, federal indirect cost recoveries and sale of documents, merchandise and property) |
| (B) Federal | (G) Investment Earnings |
| (C) Securities Lending Income | |
| (D) Licenses/Permits | |
| (E) Charges for Services/Fines/Forfeits | |

State of Montana Expenditures by Function All Governmental Fund Types



Legend:

(A) Health/Social Services
(B) Educational/Cultural
(C) Transportation
(D) General Government

(E) Public Safety/Corrections
(F) Economic Development/Assistance
(G) Resource Dev/Recreation
(H) Debt Service

(I) Capital Outlay
(J) Securities Lending

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Montana

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 1996

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Linda R. Savitsky
President

Jeffrey L. Esler
Executive Director